MANUFACTURERS HANOVER

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Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

Unity Unnerves West Germany's Markets

Positive market reaction to the agreement reached between the Bonn and East Berlin governments on the key terms for German monetary union caused the Deutschemark to appreciate to around 1.63 marks per dollar in early May, its strongest level against the dollar in over two years. However, the West German currency is once again undergoing downward pressure because of market fears about the huge financial and social costs of restructuring the East German economy.

According to the final terms of monetary union, East Germans between the ages of 15 and 60 will be allowed to convert their savings of up to 4,000 East German marks into Deutschemarks at a rate of one-for-one. They must use a rate of two-for-one thereafter. East Germans who are over 60 may swap 6,000 East German marks for Deutschemarks at a one-for-one exchange rate, while those younger than 14 may only convert 2,000 East German marks at the one-for-one rate. The agreement also stipulates that wages and pensions will be converted at the one-for-one exchange rate, while corporate debts owed to the previously state-owned banking sector will be converted into Deutschemarks at the rate of two-for-one.

Inflation Should Remain Low

Although these terms of monetary union are somewhat more generous than the Bundesbank's initial proposals, both Bundesbank President Karl Otto Poehl and West German Finance Minister Theo Waigel have emphasized that the introduction of the Deutschemark into East Germany on July 2 need not produce a surge in West Germany's inflation rate. For one thing, the increase in productivity from the united economies is expected to match the anticipated ten percent rise in the money supply. For another, rather than go on a spending spree, most East Germans will probably hold on to their savings in order to protect themselves should they become unemployed. As East Germany makes the transition to a free market economy, the sudden exposure of East German companies to international competition will cause many of them to go bankrupt and/or lay-off workers.

Most economists now believe that West Germany's year-over-year inflation rate will rise to the 3½ percent neighborhood by the end of this year. Although higher than the current rate of 2.3 percent, it will still be well below the anticipated European average inflation rate of over five percent.

With the terms of monetary union set, Finance Minister Waigel and his East German counterpart, Walter Romberg signed a treaty on May 18 intended to merge the two German economies next month. Provided that the treaty is ratified by both the East and West German Parliaments later this month, not only will the Deutschemark be legal tender in East Germany, but the Bundesbank will have responsibility for monetary policy in all of Germany. At the same time, East Germany must adopt West Germany's free-market economic policies. What is more, existing West German laws in the monetary area, including those on banking, insurance, tax and legal systems, will be extended to the East. The treaty also confirms that European Community (EC) laws will be respected in a unified Germany.

The monetary and economic union covered by the treaty is the most decisive step so far toward full unification of the two countries, expected to happen sometime next year. What the treaty doesn't cover, however, are the critical issues concerning the tremendous cost of financing the reconstruction of East German industry, agriculture and infrastructure, who will bear this cost and what help there will be for the East German companies that go bankrupt and East German workers who lose their jobs during the country's transition to free-market policies.

According to analysts in both East and West Germany, less than one-third of East German companies will be able to survive the transition without some help. At the same time, with wages in East Germany likely to rise substantially (or else workers will all move West), the number of unemployed workers is projected to reach two million, around one-fourth of the workforce, by the end of next year, versus 100,000 today.

Manufacturers Hanover Economics Department 17/270

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Concerns among West Germans that paying for this will mean higher taxes and lower living standards for them were a major reason why Chancellor Kohl's ruling Christian Democrat Party did so poorly in last month's election. They lost control of the upper house of Parliament to the opposition Social Democrats. With their new ability to block legislation, the Social Democrats are now demanding that the treaty on economic and monetary union include measures to help East German companies and unemployed workers.

But Hefty Borrowing May Boost Interest Rates

This squabbling between the two parties has refocused the attention of the financial/currency markets on the huge financial and social costs of restructuring the East German economy. Widespread market nervousness about these costs, in turn, has resulted in a decline of the Deutschemark, as well as of West German bond and equity prices, in recent days.

Although it is impossible to determine the additional strain that financing German unity will place on West Germany's public sector, the Bonn government estimates this cost at around 50 billion marks (almost $30 billion) per year. Given the Bundesbank's firm anti-inflation stance, the rise in public spending is highly un-

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/16/90)	215,378	- 191	- 973
New York City (5/23/90)	39,621	- 87	- 3,578
Commercial Paper (5/23/90)	549,446	- 948	+ 47,654

Bank Loans

(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Commercial and Industrial Loa			
Nationwide (5/16/90)	325,742	- 996	+ 8,840
New York City (5/23/90)	58,717	- 1,137	- 714
Total Loans and Leases Gross Adj			
Nationwide (5/16/90)	1,013,926	+ 2,659	+ 57,829
New York City (5/23/90	181,323	- 2,640	+ 4,638

Financial Markets

	Friday 6/1/90	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.93%	- .06	- .71
180-Day Bills†	7.99	- .17	- .58
Longest Bills†	8.04	- .18	- .52
Recent Issues:			
8½s 5/31/92	8.29	- .23	
8½s 3/30/94	8.38	- .24	
8⅞s 5/15/00	8.42	- .26	
8¾s 5/15/20	8.42	- .24	
Municipals:			
Bond Buyer—20 Bond Index* (5/31/90)	7.26%	–0–	+ .11
Blue List Total ($ Million)	$1,340	+ $182	+$ 114
30-Day Visible Supply ($ Million)	$1,816	- $259	- $1,497
Total	$3,156	- $ 77	- $1,383
Corporates:			
Moody's Aa Composite (5/31/90)	9.60	- .02	+ .02
30-Day Visible Supply ($ Million)	$ 880	+ $225	- $1,075
Stocks:			
Dow-Jones Averages:			
Industrials	2,900.97	+ 80.05	+383.14
Transportation	1,190.15	+ 37.41	+ 31.84
Utilities	211.71	+ .44	+ 8.24
65 Stocks	1,049.65	+ 25.53	+ 91.42
N.Y.S.E. Composite Index	198.03	+ 4.32	+ 16.54
N.Y.S.E. Avg. Daily Vol. for Week (000's)	173,152	+ 9,682	- 18,296

*34% Taxable equivalent 11.00%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 6/1/90	Week Ago
Overnight	8.06%	8.06
1 month	8.19	8.13
3 month	8.19	8.25
6 month	8.25	8.38
1 year	8.38	8.63

FOREIGN EXCHANGE SPOT RATES

New York Opening (6/1/90)	Currency Per U.S. $	Week Ago
Belgium	34.85	34.65
Canada	1.1723	1.1838
France	5.7140	5.6615
Germany	1.6937	1.6822
Italy	1246.50	1235.00
Japan	151.35	149.80
Mexico	2799.00	2794.00
Netherlands	34.85	34.65
South Korea	703.19	703.68
Switzerland	1.4365	1.4232
Taiwan	27.15	27.18
U.K.*	1.6835	1.6909

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (6/1/90) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/
	+0.4%	-2.3

likely to be financed by printing money. At the same time, Chancellor Kohl has ruled out tax increases, insisting that a surge in tax revenues due to the robust economic growth that develops from a united Germany will make it unnecessary to raise taxes.

However, government borrowing will clearly have to rise substantially. In fact, Finance Minister Waigel has just announced plans for a special unification fund to raise 95 billion marks on the domestic markets over the next four and a half years. Thus, the combination of strong credit demand and the Bundesbank's tight monetary policy probably spells higher interest rates in Germany.

From here, it would appear that the economic policies of Germany in the early 1990s will be quite similar to those of the United States in the early 1980s: High interest rates owing to a tight monetary policy and an expansionary fiscal policy. High interest rates alone should eventually push the Deutschemark higher. This will force other countries (especially in Europe) to choose between raising their own interest rates or allowing their currencies to depreciate against the Deutschemark. That is, they may well be the ones who will have to choose between slower growth or higher inflation. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 5/30/90	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	231.388	+ 1.866	- .744
Loans to Depository Inst.	2.083	+ .720	+ .462
Float	.459	- .807	- .196
Total Reserve Bank Credit	273.363	+ 1.979	+16.776
Treasury Deposits with Federal Reserve Banks	4.562	- .712	- .592
Currency in Circulation	263.789	+ 1.363	+17.141
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	227.715	- 1.558	- 6.952
Member Bank Reserves:	5/30/90		
Total Reserves Held	58.080	- 1.089	+ 1.246
Excess (Deficiency)	1.014	+ .083	- .144
Net Free Reserves	.389	- 239	- .268

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	‡ % Change Since Year Ago
M1 (5/21/90)	807.1	+ 3.9	+ 3.4
M2 (5/21/90)	3,266.1	+ 2.7	+ 5.9
M3 (5/21/90)	4,062.9	+ 0.6	+ 2.5
Domestic Nonfinancial Debt (4th Q'89)	9,790.0	+ 2.1	+ 8.1

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 6/1/90	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.67%	7.60%	7.48%
* Federal Agencies	8.20	8.30	8.35
* Municipal Notes–High Grade (34% Taxable Equivalent)	9.09	9.29	9.33
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.21	8.29	8.38

‡ Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	8.10%	Jul.	8.05%
15- 29 days	8.10	Aug.	8.01
30- 59 days	8.13	Sep.	7.95
60- 89 days	8.13	Oct.	7.91
90-179 days	8.12	Nov.	7.90
180-239 days	8.00	Dec.	7.85
240-270 days	8.00		

‡ Industrial Paper–Prime			
30- 89 days	8.13%	†Federal Funds Effective Rate	8.31%
90-120 days	8.07		

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'90	$ 5,431 r	$ 5,340	$ 5,113
Gross National Product (1982 Dollars)*	1st Q'90	$ 4,188 r	$ 4,174	$ 4,107
Percent Change, Annual Rate	1st Q'90	1.3 r	1.1	3.7
Change in Consumer Prices*	Apr '90	2.4 %	6.0%	8.4%
Change in MH Cost of Living Index*	Apr '90	1.2 %	7.2%	6.0%
Change in Producer Prices*	Apr '90	- 3.6 %	- 2.4%	7.2%
Civilian Employment (Thousands of Persons) †	May '90n	118,350	118,116	117,132
Unemployment as % of Civilian Labor Force †	May '90n	5.3%	5.4%	5.2%
Personal Income*	Apr '90n	$ 4,688	$ 4,674r	$ 4,387
Leading Indicators Composite Index (1967=100) †	Apr '90n	144.9	145.2	145.8
Industrial Production Index (1977=100) †	Apr '90	108.7	109.1	108.6
Net Change in Consumer Installment Credit †	Mar '90	$ 2.62	$ 0.06	$ 5.60
U.S. Merchandise Trade Balance †	Mar '90	- $ 8.45	- $ 6.10	-$ 8.92
Plant and Equipment Expenditures*	2nd Q'90	$ 509.1(a)	$ 502.7(a)	$ 470.9
Private Housing Starts (Thousands of Units)*	Apr '90	1,245	1,321	1,341
New Construction Expenditures*	Apr '90n	$ 432.4	$ 435.6r	$ 411.9
Total Business Inventories †	Mar '90	$ 794.0	$ 794.0	$ 767.3
Total Business Sales †	Mar '90	$ 539.1	$ 535.9	$ 512.8

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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